

Service Date: July 16, 1980

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN TH E MATTER of the Application of)	UTILITY DIVISION
MOUNTAIN STATES TELEPHONE AND)	
TELEGRAPH COMPANY for authority to)	DOCKET NO. 6652
establish increased rates for)	
telephone service.)	ORDER NO. 4585a

APPEARANCES

FOR THE APPLICANT:

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FOR THE PROTESTANT:

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Montana, appearing on behalf of the Montana Consumer Counsel

FOR THE INTERVENORS:

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Alan L. Joscelyn, Attorney at Law, P.O. Box 1721, Helena,
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of the Mountain States, I nc.

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Champaign, Illinois, appearing on behalf of Telephone
Answering Services of the Mountain States, Inc .

FOR THE COMMISSION:

Calvin K. Simshaw, Staff Attorney

BEFORE:

GORDON E. BOLLINGER, Chairman
CLYDE JARVIS, Commissioner
THOMAS J. SCHNEIDER, Commissioner
JAMES R. SHEA, Commissioner
GEORGE TURMAN, Commissioner

FINDINGS OF FACT

PA RT A

General

1. On February 5, 1979, Mountain States Telephone and Telegraph Company (Mountain Bell or Applicant) applied to the Commission for authority to establish increased rates for telephone service. The tariffs filed with the application would increase billings to Mountain Bell customers by \$16.58 million over those of the test year.

2. Mountain Bell requested immediate implementation of interim rate relief in the amount of \$1,802,131 on October 17, 1979. The amount of the request was based on the testimony of Consumer Counsel witnesses, particularly George F. Hess, who determined a revenue deficiency of \$1,803,000. Proposed to receive rate increases were the centrex and local exchange service categories.

3. At its agenda meeting on October 22, 1979, the Commission voted to defer action on Mountain Bell's interim application until the hearing on permanent relief, scheduled to begin November 6th.

4. During the course of the November hearing, Mr. Hess modified his calculations, resulting in the determination of a revenue deficiency of \$4,629,000. The increase in required revenues was due to depreciation represcription and non-management wage changes.

5. On November 21, 1979, Mountain Bell submitted its Supplemental and Second Amended Application for Interim Rate Increase which requested authority to increase its revenues by \$4,352,353. To realize this increase, the Company proposed to change rates for Trim Line, Touch Tone, message toll, wide area telephone, centrex and local exchange services.

6. The Consumer Counsel filed his Response to Supplemental and Second Amended Application for Interim Rate Increase of Mountain Bell on November 28, 1979. In his response, the Consumer Counsel supported increases in the rates for Trim Line, Touch Tone, message toll, wide area telephone, supplemental and miscellaneous equipment, emergency telephone, private line and centrex services; he also recommended that disaggregation be implemented at this time.

7. On November 29, 1979, Telephone Answering Services of the Mountain States, Inc., an intervenor in this Docket, urged the Commission not to adopt any changes in the charges for private line services which would affect its member firms. The association alleged that "severe consequences" would result from the proposed increases in that area, making the changes unsuitable as the subject of interim action.

8. On December 10, 1979, the Commission granted Mountain Bell interim relief in the amount of \$3,024,420. Increased rates

were allowed in service categories where the need for higher revenues was not disputed. In compliance with the order, Mountain Bell filed tariffs, effective January 10, 1980, which increased rates for Trim Line, Touch Tone, long-distance telecommunications, wide area telecommunications, miscellaneous and supplemental equipment, centrex, emergency reporting telephone systems, service observing equipment, private line terminal and channel equipment, and semipublic PBX measured trunk services.

9. Mountain Bell submitted to the Commission a verified Motion for Forthwith Relief on February 29, 1980. The Motion sought an order from the Commission granting the utility \$14,437,000 in increased annual revenues based on a finding that the Company was experiencing a revenue deficiency of that amount. As an alternative, Mountain Bell requested further interim relief. The Commission denied the Motion on March 10, 1980 on the grounds that there were no remaining service categories where the need for additional revenue was undisputed .

10. During the month of December, satellite hearings were held in the following cities: Columbus, December 3, 1979; Billings, December 4, 1979; Forsyth, December 5, 1979; Miles City, December 5, 1979; Missoula, December 6, 1979; Broadus, December 6, 1979; Great Falls, December 17, 1979; Sidney, December 18, 1979; Choteau, December 18, 1979; Wolf Point, December 19, 1979; and Lewistown, December 20, 1979.

11. The office of the Montana Consumer Counsel has participated in the proceedings of this Docket since their inception.

PART B

RATE OF RETURN

Capital Structure

12. For the purposes of this rate case, the Commission adopts as the nominal capital structure of Mountain Bell that presented in the testimony of Consumer Counsel witness Dr. Caroline Smith (Exh. CC-5, pp. 48-49 and Exh. CC-6, CMS-1).

Mountain Bell Nominal Capital Structure

<u>Type of Capital</u>	<u>Amount (000's)</u>	<u>Percent of Total</u>
Common Equity	\$2,345,918	56.24%
Long -Term Debt	1,825,124	43.76

13. The nominal capital structure as presented by Dr. Smith and adopted by the Commission differs in two major aspects from that proposed by Mountain Bell witness Mr. William T. Danner. First, Dr. Smith has included as additional common equity the proceeds from a one for seven rights offering made in June, 1979. Second, Mr. Danner includes a component for interim debt whereas Dr. Smith does not.

14. The Commission finds that it is appropriate to include the proceeds of the 1979 rights offering because they represent a known and measurable change from the 1978 test year.

15. The Commission has consistently held that interim or short-term debt should not be included in capital structure used in ratemaking. Rate base is supported by permanent capital and not by interim financing. Mr. Danner acknowledged (Tr. 276) that Mountain Bell always replaces its interim debt with long-term

debt and common equity. Dr. Smith was correct in excluding short-term debt from Mountain Bell's capital structure in this proceeding .

Cost of Debt

16. Consumer Counsel witness, Dr. Smith, calculated an embedded cost of debt for Mountain Bell of 7.74 percent (Exh. C-6, CMS-15). Mr. Danner found a cost of debt of 7.59 percent. Consistent with its earlier finding to exclude short-term debt from the capital structure, the Commission adopts Dr. Smith's calculation of 7.74 percent as Mountain Bell's cost of debt.

Cost of Equity

17. Dr. Caroline Smith also presented testimony on behalf of the Consumer Counsel concerning Mountain Bell's cost of common equity. Dr. Smith determined that the cost of common equity to Mountain Bell fell in the range of 11.7 to 12.7 percent and used 12.5 percent in calculating her recommended overall rate of return.

18. Mountain Bell presented two witnesses who addressed the Company's cost of common equity capital. Dr. Eugene Brigham concluded that Mountain Bell's cost of common equity fell in the range of 14 to 15.4 percent. Dr. Robert Johnson found that the cost of Mountain Bell's common equity is in the range of 14.4 to 15.3 percent. Based upon the testimony of Drs. Brigham and Johnson, Mountain Bell witnesses Mr. Danner and Mr. Monte Shriver adopted 14.5 percent as the cost

of common equity in calculating the Company's overall rate of return.

19. The Commission adopts 12.6 percent as Mountain Bell's cost of common equity in this case. This finding is based primarily upon the analysis performed by Dr. Smith with one modification described later in this order .

20. All three witnesses, Drs. Smith, Brigham and Johnson, used a discounted cash flow (DCF) analysis as an integral component of their rate of return analysis. According to DCF methodology, marginal investors price a share of common stock at a level equal to the present value of expected dividends over the period which they hold the security plus the discounted resale price anticipated upon sale. If dividends are assumed to grow at a constant rate, the discount rate or investors' required rate of return is equal to the dividend yield plus that constant growth rate. The DCF model stated as a formula is:

$$\begin{array}{rcccl} \text{Total Return} & & \text{Current} & & \text{Expected Dividend} \\ \text{to Investor} & = & \text{Dividend Yield} & + & \text{Growth Rate} \end{array}$$

or

$$\text{Required Return} = \frac{\text{Expected Dividend}}{\text{Price of Common Stock}} + \text{Expected Dividend Growth Rate}$$

21 . In order to estimate the cost of common equity capital to Mountain Bell, Dr. Smith performed a DCF analysis designed to determine the cost of common equity generally for a telephone utility operating subsidiary of the Bell System. In doing so, Dr. Smith used the parent company, AT&T, market information as the basis for her study. In performing their DCF analyses, the company's witnesses, Drs. Brigham and Johnson concentrated specifically upon Mountain Bell rather than taking a look at telephone operating subsidiaries of the Bell System in general

and therefore used Mountain Bell market information in making their DCF findings. The Commission prefers the approach taken by Dr. Smith.

22. The Commission finds that for the purposes of determining a cost of common equity capital in this case, it is more appropriate to look to telephone operating subsidiaries of the Bell System in general, as Dr. Smith has done; rather than concentrating on one specific subsidiary as Drs. Brigham and Johnson have done. As is pointed out in the testimony of Dr. Smith:

Both Dr. Brigham and Dr. Johnson make the mistake of relying upon Mountain Bell data, even though only a small portion of the Company's ultimate stockholders invest directly in Mountain Bell. Mountain Bell is part of the Bell System and the analysis should be viewed in those terms. Reliance upon Mountain Bell data alone is likely to produce unreliable results, as Bell subsidiaries are more alike than they are different and short term conditions specific to a single subsidiary do not tell us much about the long term financial prospects upon which common equity costs are based. (Exh. CC-5, p. 28)

23. The record is clear in this case that 11.4 percent of Mountain Bell's common stock is owned by public stockholders and is traded in the open market while the remaining 88.6 percent is owned by the parent AT&T and is not traded on the open market. Witnesses for the Company contend that information gathered from the trading of the minority ownership (11.4 percent) is adequate to determine the cost of all common equity invested in Mountain Bell. The Commission finds that such limited information fails to provide the best measure of the cost of all common equity capital in this case.

24. Pursuant to the standards set forth in the Hope and Bluefield decisions, it is incumbent upon this Commission to

allow a return on equity adequate to allow the utility to be competitive in attracting funds in the open market. That is, the Commission must allow a return on equity such that investment from the open market in Mountain Bell will remain attractive when compared to alternative uses of the public's available funds for investment. As was pointed out by Dr. Smith (CC-5, pp. 51-52 and CC-6, CMS-17), the minority interest in Mountain Bell represents only a small portion of the total investment in Mountain Bell that has been attracted from public investment sources (i.e. common stock purchases).

25. Dr. Smith showed in CC-6, CMS-17, page 2 of 2 that whereas \$267,435,000 or 6.41 percent of the total capital of Mountain Bell has been gathered from Mountain Bell minority stockholders, \$1,577,360,000 or 37.82 percent of the total capital of Mountain Bell has been gathered from AT&T stockholders. In other words, AT&T stockholders have invested much more in Mountain Bell than have Mountain Bell minority stockholders. Therefore, in developing a return on common equity adequate to continue to attract these investments to Mountain Bell from the open market, the Commission finds that Dr. Smith's analysis which considers market information concerning AT&T common stock is superior to the analyses of Drs. Brigham and Johnson which do not.

26. The Commission also finds merit in many of Dr. Smith's other criticisms of Dr. Brigham's and Dr. Johnson's analyses. The Commission agrees that Dr. Brigham's and Dr. Johnson's dividend yield components of their DCF calculations are somewhat overstated because "projected" dividends were utilized rather than current dividend rates. In estimating the growth component of his DCF calculation, Dr. Johnson relied heavily upon Value Line growth rate projections. After much discussion by all rate

of return experts at the hearing, the Commission finds that Dr. Smith has succeeded in raising considerable doubt as to the accuracy of Value Line's growth projections relating to utilities. The Commission agrees with Dr. Smith that Dr. Brigham has placed too much reliance upon his own opinions in developing his growth projections.

27. Drs. Brigham and Johnson offer several criticisms concerning Dr. Smith's DCF analysis. The Commission finds that only one offers sufficient validity and consequence to merit adjustment of Dr. Smith's findings. In making her DCF calculation, Dr. Smith used a dividend yield of 8.2 percent (CC-5, p. 15). Dr. Smith's computation was based upon a \$5.00 dividend rate and a six-month average price of AT&T common stock of \$60.98. Dr. Johnson at Exh. C-1, page 9, criticizes Dr. Smith's use of an old average price. Dr. Smith used an average price for six months ending June 30, 1979 whereas her testimony was filed in September, 1979. Dr. Johnson states that a more current average using a 200 day moving average price through September 21, 1979 would result in an average price of \$59.58 and a dividend yield of 8.39 percent. Dr. Smith herself upon cross-examination (Tr. p. 586) stated that using price data through September, 1979 would produce a dividend yield of 8.36 percent for AT&T. The Commission agrees with Dr. Johnson that Dr. Smith's dividend yield should have used more current price information. Therefore, the Commission finds that the dividend yield of 8.36 percent using prices through September, 1979, is more appropriate than the dividend yield of 8.2 percent actually utilized by Dr. Smith in making her return on equity recommendation. Consequently, the Commission finds that Dr. Smith's recommendation of 12.5 percent return on common equity should be adjusted upward to 12.6 to account for her understatement of dividend yield in her DCF analysis.

28. The Commission finds that its adoption of 12.6 percent as the appropriate return on common equity for investment in Mountain Bell is further supported by Dr. Smith's comparable earnings studies performed on telephone utility companies, electric utilities, gas distribution companies and unregulated companies.

Double Leverage

29. Consumer Counsel witness Dr. Caroline Smith strongly urged this Commission that in determining a fair rate of return for Mountain Bell it give recognition to the leveraging effects inherent in the Mountain Bell-AT&T, parent-subsidary relationship:

A fair rate of return determination for Mountain Bell should be made in a manner which gives recognition to the leveraged capital structure of Mountain Bell and its parent, American Telephone & Telegraph Company, on that part of Mountain Bell's equity which is financed indirectly through AT&T. Because Mountain Bell is a subsidiary of AT&T, and because AT&T finances its investments in part through the issuance of debt and preferred stock, a fair rate of return to ultimate common equity investors in Mountain Bell will be realized if the indirect investment through AT&T is properly taken into account. (CC-5, p. 48)

30. Dr. Smith suggests three alternative methods that could be adopted by the Commission to recognize the presence of AT&T's leverage in Mountain Bell's true capital structure. The methods suggested are the double leverage approach, the Bell System consolidated capital structure approach and the hypothetical capital structure approach . In the last Mountain Bell rate case, Docket No. 6496, the Commission adopted the double leverage

approach. Because the record in this case contains a much more thorough examination of the double leverage approach; the Commission remains even more strongly convinced that it is the best method available to account for the presence of AT&T's leverage in determining a fair rate of return for Mountain Bell. Therefore, the Commission adopts the double leverage approach as proposed by Dr. Smith in this case.

31. The Commission is aware that the true nature of AT&T's investment in Mountain Bell is not apparent on the face of Mountain Bell's "nominal" capital structure adopted in Finding of Fact No. 12. Dr. Smith points out:

The 88.6 percent of Mountain Bell's common equity capital owned by AT&T represents a combination of debt and equity investments by the capital markets, as well as deferred credits included in the AT&T parent capital structure. These capital market investments in Mountain Bell are indirect ones, in that they are initially investments in the common equity, preferred stock and debt of the Bell System. Because of the indirect character of AT&T's investment in Mountain Bell, the Company's true capital structure includes preferred stock as well as more debt and less equity capital than does the Company's nominal capital structure. (CC-5, pp. 49-50)

32. In order to determine Mountain Bell's true capital structure, one must first look to the parent AT&T's capital structure. AT&T's capital structure taken from CC-6, CMS-16 is as follows:

Capital Structure - AT&T Parent

<u>Type of Capital</u>	<u>Amount (Millions)</u>	<u>Percent of Total</u>
Common Equity	29,701	75.89%
Preferred Stock	2,101	5.37
Long - Term Debt	6,888	17.60
Deferred Taxes	446	1.14

33. The Commission finds that AT&T's investment in Mountain Bell is not financed entirely from AT&T's common equity and should not be treated as if it were. Dr. Smith describes the situation this way:

The portion of Mountain Bell's equity capital which is provided by AT&T is not financed in total by AT&T equity capital. AT&T raises capital in many ways including deferred taxes, investment tax credits, and senior securities. All of the capital dollars raised through common equity, preferred stock, long-term debt and deferred credits are available for corporate purposes. Therefore, any of those capital dollars are available as an equity investment in the subsidiaries owned by AT&T. (CC-5, p. 52)

The Commission further finds that it is only fair to treat AT&T's investment in Mountain Bell as being funded by a mixture of common equity, preferred stock, long-term debt and deferred taxes in the same proportion as those elements are present in AT&T's capital structure. The rate-making treatment advocated by the Company's witnesses (i.e. no double leverage recognition) would result in AT&T's investment in Mountain Bell being treated as if it were funded entirely by common equity. The Company's position in this regard is entirely unrealistic as is evidenced by the fact that there is not enough common equity present in AT&T to allow all of the parent's investments in its subsidiaries to be funded solely from its own common equity.

34. Consequently, the Commission chooses to treat AT&T's investment in Mountain Bell's nominal common equity as being composed of the following elements:

Breakdown of AT&T's Investment in Mountain Bell

<u>AT&T Capital Invested in Mountain Bell</u>	<u>Amount (000's)</u>	<u>Percentage of Total Investment</u>
Common Equity	\$1,577,360	75.89%
Preferred Stock	111,615	5.37
Long - Term Debt	365,813	17.60
Deferred Taxes	<u>23,695</u>	<u>1.14</u>
 Total AT&T Investment in Mountain Bell	 \$2,078,483	 100.00%

Total investment of \$2,078,483,000 is 88.6 percent of Mountain Bell's nominal common equity. The various percentages are derived from AT&T's capital structure found in Finding of Fact No. 32.

35. Recognizing the underlying nature of AT&T's investment in Mountain Bell, the true capital structure of Mountain Bell may be set out as follows:

True Capital Structure of Mountain Bell

<u>Type of Capital</u>	<u>Amount (000's)</u>	<u>Percent of Total</u>
Common Equity (Mountain Bell Minority Shareholders)	\$ 267,435	6.41%
Indirect Common Equity (AT&T)	1,577,360	37.82
Preferred Stock (AT&T)	111,615	2.67
Debt (Mountain Bell)	1,825,124	43.76
Indirect Debt (AT&T)	365,813	8.77
Deferred Taxes (AT&T)	<u>23,695</u>	<u>.57</u>
	 \$4,171,042	 100.00%

The components labeled (AT&T) are derived from Finding of Fact No. 34 and represent that portion of Mountain Bell's nominal common equity which was invested by AT&T and funded by the various AT&T capital components. The amount labeled (Mountain Bell Minority Shareholders), is 11.4 percent of Mountain Bell's nominal common equity. The debt labeled (Mountain Bell) is debt issued directly by Mountain Bell and is derived from Mountain Bell's nominal capital structure, Finding of Fact No. 12.

36. Upon examination of the underlying nature of AT&T's investment in Mountain Bell, the Commission finds that the cost of Mountain Bell's nominal common equity capital invested by AT&T is lower than the 12.6 percent found to be the cost of common equity capital to a Bell System operating subsidiary. Failure by this Commission to recognize this fact would unnecessarily burden the Montana intrastate ratepayer. Dr. Smith describes why this is so at CC-5, page 50 and page 55.

Since the large majority of Mountain Bell's nominal common equity capital is attracted to the enterprise at the AT&T level, the rate of return authorized on Mountain Bell's nominal equity funds should provide for adequate capital attraction and earnings comparability at the AT&T level. If the indirect investment through AT&T were treated instead, as the Company advocates, as if it were wholly financed by common stock investors, the result would be a windfall profit to AT&T in excess of the common equity capital return required by AT&T's common stockholders who have indirectly invested in Mountain Bell and the other operating subsidiaries of the Bell System. This is an unnecessary reward to AT&T's ultimate stockholders at the expense of telephone utility ratepayers. (CC-5, p. 50)

The essential point is that AT&T's investment need earn only the cost of those funds supplied to Mountain Bell. (CC-5, p. 55)

As is shown below, the cost of AT&T's funds supplied to Mountain Bell is less than 12.6 percent which is the cost they would be given if the Commission did not make some allowance for the effects of double leverage.

37. The cost of AT&T's investment in Mountain Bell is determined in much the same manner as the Commission would use in determining the cost of capital for an independent private utility. In Finding of Fact No. 34 it was established that AT&T's investment in Mountain Bell would be treated as being

funded by proportional components of common equity, preferred stock, long-term debt and deferred taxes. It is clear that the deferred taxes component should be assigned a cost of zero percent. Dr. Smith calculated a cost of 7.63 percent and 6.04 percent for the preferred stock and long term debt components respectively (CC-6, CMS-16). Neither of these calculations was contested by the Company and are considered valid by the Commission. The 12.6 percent cost of common equity developed earlier in this order is appropriately assigned as the cost associated with the common equity component of AT&T's investment in Mountain Bell. As discussed earlier, that number was derived primarily from Dr. Smith's DCF analysis which utilized AT&T's market information. Assigning a cost of 12.6 percent allows for a return sufficient to continue to attract from the open market that portion of AT&T's common equity funds which are ultimately invested in Mountain Bell.

38. Assigning the various costs found in Finding of Fact No. 37 to the respective AT&T capital components found in Finding of Fact No. 34 yields 11.03 percent as the cost of funds supplied to Mountain Bell by AT&T:

Cost of AT&T Funds Invested In Mountain Bell

AT&T Capital Invested in Mountain Bell	Amount (000's)	Percent of Total	Cost Rate	Weighted Cost
Common Equity	\$1,577,360	75.89%	12.6	9.56%
Preferred Stock	111,615	5.37	7.63	.41
Long - Term Debt	365,813	17.60	6.04	1.06
Deferred Taxes	<u>23,695</u>	<u>1.14</u>	<u>-0-</u>	<u>-0-</u>
Total	\$2,078,483	100.00%		11.03%

39. When the various costs associated with AT&T funds invested in Mountain Bell are considered with the 12.6 percent

cost of Mountain Bell's minority interest common equity and the 7.74 percent cost of Mountain Bell's own debt and then applied to Mountain Bell's true capital structure found in Finding of Fact No. 35, the overall cost of capital to Mountain Bell of 9.7 percent is revealed

Mountain Bell's Cost of Capital

<u>Type of Capital</u>	<u>Amount (000's)</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Common Equity (Mountain Bell minority shareholders)	\$ 267,435	6.41%	12.6%	.81%
Indirect Common Equity (AT&T)	1,577,360	37.82	12.6	4.77
Preferred Stock (AT&T)	111,615	2.67	7.63	.20
Debt (Mountain Bell)	1,825,124	43.76	7.74	3.39
Indirect Debt (AT&T)	365,813	8.77	6.04	.53
Deferred Taxes (AT&T)	<u>23,695</u>	<u>.57</u>	<u>-0-</u>	<u>-0-</u>
Total	\$4,171,042	100.00%		9.70%

40. The same 9.7 percent overall cost of capital can be achieved by applying the 11.03 percent overall cost of AT&T's funds to AT&T's share of Mountain Bell's nominal common equity:

Mountain Bell's Cost of Capital

<u>Type of Capital</u>	<u>Amount (000's)</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
Nominal Common Equity:				
Minority Shareholders	\$ 267,435	6.41%	12.6 %	.81%
Shares Held by AT&T	2,078,483	49.83	11.03	5.50
Long -Term Debt	<u>1,825,124</u>	<u>43.76</u>	7.74	<u>3.39</u>
Total	\$4,171,042	100.00%		9.70%

41. The Commission finds that Mountain Bell's composite cost of capital is 9.7 percent and that consequently for the purposes of this

proceeding the Company is entitled to an overall rate of return of 9.7 percent.

42. By granting a 9.7 percent overall rate of return to Mountain Bell in this proceeding the Commission has provided for recovery of all of Mountain Bell's costs of capital including the 12.6 percent necessary to continue to attract funds from the open market in the form of public common stock purchases (i. e. both the Mountain Bell minority shareholder and the AT&T shareholder). This can be shown as follows:

Overall return allowed Mountain Bell	9.70%
Less: Mountain Bell's weighted cost of debt	-3.39
Less: Weighted return to minority shareholders at 12.6 percent	<u>- .81</u>
Equals: Weighted return to shares owned by AT&T	5.50%
Equals: Actual return to AT&T (5.50 percent weighted return - 49.83 percent which is the percentage of total Mountain Bell capital supplied by AT&T)	11.04%
Less: Weighted cost of AT&T debt invested in Mountain Bell	-1.06
Less: Weighted cost of AT&T preferred stock invested in Mountain Bell	<u>- .41</u>
Equals: Weighted return to AT&T common equity invested in Mountain Bell	9.57%
Return to Mountain Bell minority shareholders (.81 percent weighted return - 6.41 percent which is the percentage of total Mountain Bell capital represented by minority common stock)	12.6%
Return to AT&T common shareholders (9.57 percent weighted return - 75.89 percent which is the percentage of total AT&T capital represented by common stock)	12.6%

43. The same methodology can be utilized to show the unwarranted windfall return to AT&T common shareholders if no allowance was made for the effects of leveraging (i.e.

"double leverage" not applied by the Commission). Failure to apply double leverage would provide a return of 12.6 percent to all of Mountain Bell nominal common equity including that owned by AT&T. This would result in an overall rate of return of 10.5 percent calculated as follows:

<u>Type of Capital</u>	<u>Amount</u> <u>(000's)</u>	<u>Percent of</u> <u>Total</u>	<u>Cost</u> <u>Rate</u>	<u>Weighted</u> <u>Cost</u>
Nominal Common Equity:				
Minority Share Holders	\$ 267,435	6.41%	12.6%	.81%
Shares Held by AT&T	2,078,483	49.83	12.6	6.28
Long -Term Debt	<u>1,825,124</u>	<u>43.76</u>	7.74	<u>3.39</u>
Total	\$4,171,042	100.00%		10.48%

Allowing for the various costs of capital would reveal the following returns to the ultimate investors:

Overall return allowed Mountain Bell	10.50%
Less: Mountain Bell's weighted cost of debt	-3.39
Less: Weighted return to minority shareholders at 12.6 percent	<u>- .81</u>
Equals: Weighted return to shares owned by AT&T	6.30%
Equals: Actual return to AT&T (6.30 percent weighted return • 49.83 percent which is the percentage of total Mountain Bell capital supplied by AT&T)	12.64%
Less: Weighted cost of AT&T debt invested in Mountain Bell	-1.06
Less: Weighted cost of AT&T preferred stock invested in Mountain Bell	<u>- .41</u>
Equals: Weighted return to AT&T common equity invested in Mountain Bell	11.17%
Return to Mountain Bell minority shareholders	

(.81 percent weighted return - 6.41 percent
which is the percentage of total Mountain Bell
capital represented by minority common stock) 12.6%

Return to AT&T common shareholders (11.17 percent
weighted return - 75.89 percent which is the percentage
of total AT&T capital represented by common stock) 14.7%

The Commission finds that failure to apply the double leverage approach in order to recognize the effects of the parent company's leverage would allow for a 14.7 percent return to AT&T common shareholders on their indirect investment in Mountain Bell whereas this Commission has already determined that a return of 12.6 percent is adequate. The additional 2.1 percentage points of return would be unjustly reaped at the expense of the Montana intrastate telephone ratepayer. Therefore, any overall rate of return not recognizing the effects of the parent company's leverage is totally unacceptable to the Commission.

44. Mountain Bell witnesses were quick to point out that a distribution of the allowed overall rate of return such as that displayed in Findings of Fact Nos. 42 and 43 cannot occur in reality. This is because Mountain Bell has only one class of stock and the same return must be made to all shares regardless of whether owned by the public (minority) or AT&T. The Commission recognizes the fact that the 9.7 percent overall return it has allowed using the double leverage approach will result in an 11.21 percent return on all shares of Mountain Bell common stock. However, whereas the minority shareholder will receive an 11.21 percent return, the other ultimate investors, AT&T common shareholders, will receive a 12.83 percent on their investment in Mountain Bell. The Company submitted that because under the double leverage approach minority shareowners would realize less than the

cost of equity found by the Commission, that such an approach was improper and should be abandoned. For the reasons stated below, the Commission strongly disagrees.

45. The Commission in determining an overall rate of return for Mountain Bell has allowed for a return of 12.6 percent to all ultimate (as opposed to nominal) common equity investors. The reason this will not come to pass in reality and the reason that AT&T common shareholders will receive a return higher than 12.6 percent at the expense of Mountain Bell minority shareholders is the manner in which the Bell System has chosen to structure the ownership of Mountain Bell. The discrepancy between the return realized by the minority shareholders and AT&T shareholders is not caused by the action this Commission has taken in adopting the double leverage approach. The discrepancy is caused by the inherent ownership structure (i.e. parent subsidiary relationship with a minority interest) and would occur regardless of whether double leverage was applied or not. Company witness Mr. William T. Danner admitted as much upon examination by Commission staff counsel:

Q. (By Mr. Simshaw) Will you agree, Mr. Danner, that the AT&T stockholder is going to earn more on his investment in Mountain Bell than the minority stockholder whether double leverage is applied or not?

A. Yes. (Tr. p. 316)

Specifically addressing the effects of double leverage upon the return to minority shareholders Dr. Smith testified:

Mr. Danner is incorrect in his assertion that reflecting the parent's leveraging "does not provide these shareowners the opportunity of earning the rate of return found to be fair."

If that is the result, it is because Mountain Bell chooses to shortchange them. The fair return has been included, and they will receive less only if the Bell System keeps more. (CC-S, p. 57)

46. The Commission recognizes that under Mountain Bell's current ownership structure, the Bell System is likely to take the 9.7 percent overall rate of return allowed by the Commission and distributed it in such a manner that the minority shareholders will receive less than a 12.6 percent return on their investment. This unfortunate situation must be balanced very carefully against the consequences of not accounting for the effects of double leverage. The 9.7 percent overall rate of return found using double leverage results in a few ultimate investors, the minority shareholders, earning less than 12.6 percent; but by the same token results in most of the ultimate investors, AT&T shareholders, earning more than the 12.6 return required to attract investment. Ignoring the effects of double leverage and thereby allowing a 12.6 percent return on Mountain Bell common stock owned by the parent AT&T would result in a 14.7 percent return to those ultimate investors investing through AT&T (AT&T common shareholders) after allowing for AT&T's cost of debt and preferred stock (Finding of Fact No. 43).

47. To ignore double leveraging effects in this case would amount to telling the Montana ratepayers that even though they would already be returning a higher than necessary return to most of Mountain Bell's ultimate investors through the double leverage approach (12.83 percent to AT&T shareholders), that they must now pay even higher rates in order to bring the few remaining ultimate investors (Mountain Bell minority shareholders) up to 12.6 percent while at the same time lavishing 14.7 percent on most of the ultimate investors (AT&T shareholders). The "need" to bring

the minority shareholders back up to 12.6 percent is attributable not to the service needs of the ratepayers nor any action taken by this Commission, but rather from the action of the Bell System itself in choosing to structure the ownership of Mountain Bell in the manner it has. The Company's position asks the ratepayers to remedy an injustice against the minority shareholders that the Bell System itself has caused. The Commission finds that a grave injustice would result if double leverage were not applied and Montana ratepayers were consequently asked to contribute 2.1 percent excess return to most of the Company's ultimate investors.

48. The fact remains that the Commission with its double leverage approach has granted an overall rate of return which provides for all of the costs of capital associated with funds invested in Mountain Bell including a 12.6 percent return to all ultimate investors. The Commission has provided for an adequate return; it is up to the Bell System to distribute that return to all ultimate investors in a fair and reasonable manner.

49. Mountain Bell also attacked the double leverage approach on the basis of its treatment of retained earnings. The double leverage approach adopted by the Commission in this case assigns an 11.03 percent cost of capital to 88.6 percent of Mountain Bell's retained earnings. The Company argued that even under the double leverage approach that portion of retained earnings could not be "sourced" back to AT&T and therefore should have been assigned the full 12.6 percent cost of common equity. The Commission finds no basis upon which to treat AT&T's share of Mountain Bell's retained earnings any differently than it has treated AT&T's share of paid-in capital. Therefore, the Commission assigned the same

cost of capital to all retained earnings as it assigned to the common stock which has a claim on those retained earnings (i.e. 12.6 percent on 11.4 percent of retained earnings and 11.03 percent on the remaining 88.6 percent). The Commission finds that the cost of equity is the same regardless of whether that equity was raised in a capital market or was accumulated in the form of retained earnings. Consequently the Commission draws no distinction in this order between the cost of retained earnings and paid-in capital.

50. Finally the Company argued that it had not been shown that AT&T common shareholders would receive the required return on equity under the double leverage approach because AT&T shareholders earn their return from the entire Bell System consolidated which was not fully considered in this case. The Commission finds no need to trace the return it has allowed in this case through the Bell System consolidated to the AT&T common shareholder. The Commission has merely provided AT&T with all of the costs associated with its investment in Mountain Bell including the cost of common equity. AT&T should expect no more from this Commission. The Commission fails to see why, if every other regulatory body would also provide AT&T with its cost of funds invested in all other Bell System subsidiaries, this would not result in AT&T recovering its cost of equity and distributing the same to its common shareholders. If there is something in the make-up of the Bell System as a whole which prevents this, the Commission does not feel compelled to require the Montana ratepayers to remedy such a defect.

51. The Commission finds that the double leverage approach is appropriate in this case and has correctly

identified 9.7 percent as Mountain Bell's overall cost of capital.

PART C

Revenue, Expense and Rate Base

52. Mr. Shriver sponsored exhibits and testified to cost of service and rate base amounts for the Company. His direct testimony and accompanying exhibits have been marked "E" and "5" respectively while his rebuttal testimony and exhibits were marked "N-1" and "14-1." His supplemental testimony and exhibits were marked "N" and "14."

G. F. Hess testified for the Consumer Counsel in these areas and his testimony and exhibits were denoted "CC-4."

53. The purpose of Shriver's supplemental data is not to change the revenue requirement of \$16,123,000 requested in "E" and "5" (which are based on six months actual and six months estimated data for 1978), but rather to present actual 1978 data and the associated revenue requirement of \$18,757,000 for Commission "consideration" in these proceedings and "to give the parties and the Commission the opportunity to utilize fully actual data." (Shriver, Exh. N, p. 2). It should be noted that by using this supplemental data (which intervenors do use in their exhibits) at least partial effect is given to the increased revenue requirement of \$18,757,000. The Commission has long been dedicated to the use of actual data rather than forecasts, however. It is with this in mind that the Commission finds the historic year of 1978 to be an appropriate test year with average beginning and end of year amounts appropriate for rate base purposes.

54. Mr. Shriver included an adjustment for deferred income tax expenses on the book-tax timing differences pertaining to certain construction related expenditures; namely relief and pensions, social security taxes and state and local sales and use taxes. He also reduced the rate base by the amount of the associated accumulated deferred credit. Mr. Hess disagrees with these adjustments.

55. Mr. Shirver believes that tax expense associated with construction costs should be allocated over the serviceable life of the plant through the process of normalization:

By normalizing, expenses and taxes will be properly matched with revenues. The tax reduction for the test period will be amortized over the life of the plant, thereby distributing the benefit of the tax deferral to both present and future ratepayers. If this adjustment is not made, the full benefit of the tax savings will be given to current ratepayers, which is unfair since the plant which gave rise to the tax savings will be in service for both present and future ratepayers. (Shriver Direct p. 6)

The Commission finds, because of the steadily growing nature of telephone plant construction, that each year ratepayers will receive benefits associated with construction related expenses in the income tax calculation. This differs from the cyclical construction pattern of an electric utility, where construction of a large generating station occurs with no construction of this magnitude occurring for several ensuing years. In the instance of steadily growing telephone plant construction, the matching argument is superfluous because future ratepayers, although not receiving all the tax benefits associated with plant devoted to their service, will receive construction related tax benefits on plant in

construction at that time. This may not be true if future growth and inflation don't occur, as Mr. Hess pointed out on pages 4 and 5 of his direct testimony. The Company, however, has failed to demonstrate slowing future growth and inflation. On the contrary, its presentation regarding the cost of equity capital indicates substantial future growth and inflation.

56. Mr. Shriver stated on page 6 of his direct testimony that normalization of these tax expenses would make Mountain Bell's "income tax accounting consistent with other businesses with whom we compete for capital dollars" because all non-utility enterprises are required by the Financial Accounting Standards Board to use normalization (also see Hess Direct pp. 8 & 9). The Commission finds that the Company has failed to consider capital raised by utilities who do not use normalization and with whom Mountain Bell also has to compete for capital dollars. Also, Mountain Bell would be fully comparable to non-utilities only if it used comprehensive normalization, which it has not applied for in this case.

57. On page 7 of his direct testimony, Mr. Shriver contends that normalization "would improve cash flow by providing an additional source of non-investor supplied funds for construction of new plant. This would reduce the need for outside capital and would be beneficial to both the Company and the ratepayer." Mr. Hess pointed out on page 11 of his testimony, however, that because Mountain Bell used flow-through accounting for these items in the past that a switch to normalization at this time would be "especially harsh" on present ratepayers because no accumulated deferred tax credit arising from past years' deferrals is deductible

from the rate base. One method to alleviate this problem is to pro form an accumulated deferred tax credit amount to account for past years tax deferrals. The Company has included no such adjustment in its recommendations, however.

58. One final point deserves comment. Mr. Shriver has said that normalization increases internal cash generation and reduces the need for external financing. In considering this it must be remembered that the cost to the ratepayer of external financing is the rate of return he must pay to stockholders and bondholders for the use of their money, in this instance a composite rate of 9.7 percent. The cost to the ratepayer of internal cash generated from normalization or ratepayer financing is the opportunity cost associated with the ratepayer's money (i.e. what his rate of return would be had he invested the funds elsewhere). If he can earn a return higher than the cost of external financing, flow through is preferable. If he earns a lower return, normalization is preferable. Of course, the value of reducing rate base by the amount of accumulated deferred income tax credits under normalization must be considered, as well as any change in the bond rating and its influence on the cost of financing due to increased internal cash generation under normalization. These issues are of central importance to the normalization versus flow-through controversy and were not adequately addressed by either party.

59. The Commission finds that the Applicant has not met its burden of proof in supporting its normalization adjustment and therefore accepts Mr. Hess' tax treatment of the construction related expenditures.

60. Mr. Shriver, on pages 12-15 of his direct testimony, advocates allowing plant under construction (CWIP) in the rate base because the Federal Communications Commission (FCC) no longer allows capitalizing for accounting purposes interest during construction (IDC) on short-term construction projects. Mr. Hess disagrees.

61. On page 5 of his rebuttal testimony Mr. Shriver argues that, based on changes in the FCC Uniform System of Accounts that CWIP can now be considered used and useful. Hess, however, stated on page 13 of his direct testimony: "This Commission has repeatedly found that under Montana statutes construction work in progress cannot be included in the rate base because it is not used and useful." The Commission fails to understand how a change in FCC accounting alters the impact of Hess' statement.

62. The Commission finds Mr. Hess' adjustment preferable. It should be noted that he recommends that the Company, for rate-making purposes, continue capitalizing IDC. The Commission finds this acceptable.

63. Mr. Shriver has made provision for the effects of property taxes in computing the company's gross revenue requirement. Mr. Hess does not account for property taxes in his gross revenue computation.

64. Mr. Shriver contends that because income is one of the factors in computing property taxes that each increase in income will be accompanied by an increase in property taxes. Hess stated on pages 13 and 14 of his direct testimony that a one or two year lag exists between the time income has

increased and the resulting reflection in property taxes. Mr. Shriver acknowledges this on pages 8 and 9 of his rebuttal:

Q. But is there not a one year lag between the time of increased earnings and increased property taxes?

A. That is correct, and that is the dilemma we are faced with in establishing rates for the future, particularly since we cannot predict the time interval between rate proceedings. It can be reasonably presumed that under present property tax valuation procedures there will be a property tax increase in the year following a general rate increase.

65. The Commission finds that the effects of property tax increases (if indeed they occur) are outside the scope of this test year. It should also be noted that Department of Revenue personnel each year assign a different weighting to income in the property tax equation, which makes its effect difficult to measure precisely. The Commission therefore accepts Hess' adjustment.

66. Mr. Shriver recommended that the Commission consider an attrition allowance because increasing plant investment per telephone due to inflation causes revenue erosion. Mr. Hess disagreed.

67. Mr. Shriver stated on page 22 of his direct testimony that growth in end-of-period net investment over average test year investment graphically shows the effects of attrition. Hess, however, on page 23 of his direct testimony stated: "Mr. Shriver has made no attempt to evaluate the additional revenues which year-end rate base would produce, and, thus, offset the calculated attrition in earnings."

68. Mr. Shriver contends on page 21 of his direct testimony that inflation is the main cause of attrition. He

ignores the fact, however, that future inflation is not precisely measurable.

69. The Commission finds that the Company's attrition adjustment is not precisely measurable and rejects it.

70. On pages 14-18 of his direct testimony Mr. Hess proposed a total factor productivity adjustment to reflect the more efficient use of the factors of production by Mountain Bell. Mr. Shriver appears to acknowledge the presence of total factor productivity in his rebuttal testimony but says it should be offset by an inflation or attrition adjustment (Shriver, pp. 9-12).

71. Mr. Hess contends that because productivity gains have occurred in past years that they will probably occur in the future, and are therefore measurable. Using a conservative approach he applies a lower than historical rate only to wages and benefits, the only significant expense adjusted for post test year known and measurable changes. The Commission finds that future productivity gains are measurable with the same precision as future inflation.

72. On page 18 of his testimony, Mr. Hess stated that in Colorado: "Mountain Bell proposed and the commission accepted a 6.1 percent productivity offset to out-of-period wage increase. " This Commission finds that rate-making, however, must consider all factors, and it is not familiar with or governed by other practices followed by the Colorado commission.

73. The Commission finds in order to be consistent with the position it has taken on inflation adjustments that it must reject Mr. Hess' productivity adjustment.

74. At page 16 of his direct testimony and pages 12 and 13 of his rebuttal testimony, Mr. Shriver discussed the Company's need for cash working capital. Mr. Hess refutes these arguments at page 20 of his direct testimony.

75. Mr. Shriver contends that the Company has day-to-day cash requirements and that: "To the extent that these cash requirements are provided by current liabilities or any other source of funds, including zero cost capital, I have recognized this fact in the development of my weighted cost of capital shown on page 3 of Exhibit 14. " (Shriver Rebuttal, p. 13) The Commission has found elsewhere in this order, however, that current liabilities are not properly included in the weighted cost of capital. Also Mr. Hess pointed out: "Mountain Bell's total capital obligations are less than its average net investment which indicates a negative cash requirement." (Hess Direct, p. 20) The Commission notes that Mountain Bell computes cash working capital to be 1/12 of total annual operating expenses (less depreciation) but fails to substantiate why that particular formula should be allowed.

76. Finding that Mountain Bell has not adequately substantiated their cash working capital adjustment, the Commission denies it.

77. Witnesses who testified for the Company on the appropriate level of license contract expenditures paid by Mountain Bell to AT&T were:

- (1) R. Donat, who sponsored direct testimony (F), exhibits (6) and rebuttal testimony (F-1);
- (2) K. L. Schneider, who sponsored direct testimony (G), exhibits (7) and rebuttal testimony (G-1); and
- (3) C. W. Lonquist, who sponsored rebuttal testimony (0-1) and exhibits (15-1).

Richard Gabel testified on behalf of the MCC and his direct testimony and exhibits are denoted CC 16.

78. The current license contract agreement between Mountain Bell and AT&T was entered into August 5, 1930 and purports to cover AT&T services, licenses and privileges provided to Mountain Bell. The rate charged Mountain Bell for these services between 1948 and 1974 was 1 percent of its gross operating revenues. Starting October 1, 1974 AT&T started billing Mountain Bell an amount equal to each licensee's allocated share of total costs, not to exceed 2 1/2 percent of gross operating revenues.

79. The amount of expense applied for by the Company in this proceeding for the year 1978 is \$1,628,000 or 1.94 percent of gross operating revenues (R. Donat, Exh. 6, p. 1, part 5). Mr. Gabel recommends that no license contract expense be allowed (Gable Direct, p. 22).

80. Gabel points out on page 4 of his direct testimony that: "The allocation of [license contract] costs to intrastate Montana business is derived simply as an apportionment, rather than a determination of cost. " The Commission has allowed apportionment of "indirect" costs to this jurisdiction in other proceedings, but only after thorough review of convincing evidence. The burden of

substantiating these kinds of costs is clearly on the Applicant.

81. Gabel and Company witnesses differ in at least two areas:

In reading Mr. Gabel's testimony two major themes appear to surface. The first is Mr. Gabel's allegation that much of the work performed by AT&T under the License Contract is conducted to directly benefit the investors of AT&T and that the costs of such work should be recovered from the shareholder group. The second major theme proffered by Mr. Gabel is that certain License Contract work performed by AT&T and Bell Telephone Laboratories is performed to benefit Western Electric Company and as such the costs should be borne by Western and recovered in the price of their products. (Donat Rebuttal, pp. 1, 2)

82. With regard to the first point of contention Gabel stated in his direct testimony that license contract charges erroneously include:

- A. Expenses incurred by AT&T to service its securities (p. 13);
- B. Secretarial duties associated with AT&T stockholders and stockholder meetings (p. 14);
- C. Expenses associated with charitable contributions and advertising relative to corporate image (pp. 14, 15);
- D. Investor related legal matters (p. 15);
- E. Development of a functional accounting system to benefit in large part the investor (p. 16);
- F. Customer relation and complaint activities that are duplicative of those activities engaged in by Mountain Bell (pp. 17, 18);
- G. Expenses related to unfair employment practices (p. 19);

- H. Expenses for income taxes even though AT&T has no tax liability (p. 19);
- I. Investor related costs pertaining to holding company functions (p.20);
- J. Investor related costs pertaining to management of investor interests in AT&T (p. 20).

The amount of expense Gabel associated with these items is \$337,753.

83. Mr. Schneider alleged in his rebuttal testimony that Gabel has utilized these isolated instances as a foundation for disallowing all license contract expenses while "choosing to ignore the total work effort of the AT&T General Department and Bell Laboratories" (p. 5). The burden of proof is on the Applicant, however. Mountain Bell should not expect the total work effort of AT&T and Bell Laboratories to be adequate justification for inappropriate expenses. Along this line the Commission fails to find a Company recommendation which does not include amounts related to advertising, charitable contributions or the stockholders annual meeting -- expenses long held in disfavor in this jurisdiction. Other license contract expenses referenced in Gabel's testimony also appear to be of dubious value to ratepayers.

84. The Company contends should investors be required to bear additional costs now recovered through license contract charges, that rate of return allowances should be increased to compensate them for the additional risk (Donat Rebuttal, p. 2). The Commission dismisses this contention because the rate of return calculation automatically compensates the investor for expenses properly attributable

to him through the growth calculation done in applying the DCF model.

85. With regard to the second point of contention, Gabel stated in his direct testimony that license contract expenses erroneously include:

- A. Marketing activities properly attributable to Western Electric --and properly recoverable through the prices charged by Western Electric for equipment sold to Mountain Bell (pp. 16, 17);
- B. Expenses related to product development (which should be charged to Western Electric) (p . 18);
- C. Charges for certain research and development performed by Bell Telephone Laboratories (which should be charged to Western Electric) (pp. 7-12).

The total amount of expense Gabel associated with these items is \$727,676.

86. Mr. Gabel contends if the Montana ratepayer is charged with these expenses that Western Electric will hold a competitive advantage over other equipment suppliers who must include such amounts in their prices:

- Q. Would you then summarize your observations with respect to the license contract funding of Bell Telephone Labs R&D expenditures?
- A. It would appear that funding of this effort through the license contract payments aids Western Electric directly. No other telecommunications manufacturer in the country has a comparable advantage. This assistance to Western constitutes, in effect, a subsidy which acts as a barrier to potential entrants and a handicap to existing suppliers in the telecommunications industry. The R&D funding through license payments gives Western a price advantage over present and potential competition. (Gabel Direct, p. 10)

87. Lonnquist alleged on pages 11 and 12 of his rebuttal testimony that the quality of research and development, if left to the equipment manufacturers, would suffer and would not be adequate for the utilities needs:

One must expect that non-integrated suppliers and manufacturers would be motivated to pursue those areas that would improve their competitive product positions. They would tend to advance those areas only at the rate necessary to insure their own economic success.

Under the license contract agreement AT&T personnel determine what research and development will be performed rather than direct marketplace pressures (Donat Direct, pp. 46, 47). The Commission has more confidence in the marketplace to determine what kind and what level of research and product development are to be done. One way to promote competition in this instance is to remove direct ratepayer subsidy of BTL research and product development.

88. On page 23 of his rebuttal testimony Lonnquist argues that BTL research has resulted in much of the advanced technology used in telephony:

To my knowledge, no telecommunications manufacturer does Basic and Applied Research in technology with the same scope and depth as Bell Laboratories. Bell Laboratories has a worldwide reputation for leadership. One example of this recognition was contained in comments dated June 6, 1977, submitted by G.T. E. Service Corporation and its affiliated Operating Telephone Companies in the FCC's "Computer Inquiry II", Docket 20828. These comments stated that "Technical leadership is largely provided by Bell Laboratories which has been responsible for the development of much of the electronic technology now at the disposal of the

telecommunications operating and manufacturing companies (and others.)" The research performed by manufacturers is simply not the type of research performed at Bell Laboratories.

The Commission questions the logic of this statement. Why should Montana Mountain Bell ratepayers pay for research that benefits the ratepayers of G.T.E. ?

89. Mr. Gabel also finds fault with the ratepayer paying for research and development "up front" through the license contract agreement rather than in the price of the product (Gabel Direct, p. 6, II. 6-19). There are three possible end products of BTL's research: (1) It ultimately benefits the ratepayer, (2) It ultimately benefits Western Electric's competitive position or (3) It ultimately is useless. If the ratepayer pays for research and development up front and it ultimately benefits the ratepayer, he then has paid for a portion of a product long before it becomes used and useful and is dedicated to his service. If the research and development benefits Western Electric's competitive position or is useless, the ratepayer has assumed the risk of research and development more properly attributable to the stockholders of AT&T, the ultimate owners of Western Electric.

90. With regard to both points of contention as referenced in Finding No. 81, Donat argued on pages 29-31 of his direct testimony that the license contract agreement allows for centralization of services thereby effecting economies of scale. He also stated that it would cost Mountain Bell more to perform these services on a separate company basis in the absence of the license contract agreement. According to Donat: "All of this is possible because of the similarity of operating problems and customer

needs throughout the country. " (p. 30) The Commission fails to find in evidence, however, testimony showing how conditions in Montana are similar to those in other parts of the United States, particularly more heavily populated areas.

91. In considering the questions raised above, the Commission finds that Mountain Bell has failed to meet its burden of proof in demonstrating the reasonableness and propriety of, at the very least, those amounts specifically addressed in Gabel's testimony, a total of \$1,065,429 (\$337,753 + \$727,676) of the license contract expense of \$1,628,215 claimed by the Company.

92. In its Order No. 4389d, the Commission's most recent Mountain Bell general rate order, the Company was granted license contract expenses of \$678,000. Absent demonstration that the applied for amount in that case was justified, the Commission held this to be a reasonable level of expense. It was also based on MCC witness Gabel's recommendation. The Commission finds that this amount is still a reasonable license contract expense level and closely matches that specifically addressed in MCC witness Gabel's testimony in this proceeding, and it is therefore approved.

93. Company witnesses who testified on interstate foreign exchange cost allocations were:

- (1) M. R. Shriver, who sponsored rebuttal testimony (N-1) and exhibits (14-1); and
- (2) K. V. Ishoy, who sponsored rebuttal testimony (L-1).

Richard Gabel testified on behalf of the MCC, and his testimony and exhibits are denoted CC-22.

94. An interstate foreign exchange subscriber receives a local telephone number from a central office in another state and is able to receive and originate local calls on the same basis as any other local exchange subscriber in the distant exchange. Under Mountain Bell's Division of Revenue arrangements, the investment in inter-exchange plant is allocated to interstate operations while the investment in local exchange plant is assigned to the state jurisdiction. Witness Gabel specified that local exchange plant and costs associated with interstate FX should also be allocated to interstate operations .

95. Mr. Shriver on page 19 of his rebuttal testimony stated that the Montana Commission should not follow Gabel's method of cost allocation because it would place Montana in a position inconsistent with that of other states. The New York Commission, however, has recently imposed a local access charge on interstate FX usage, recognizing the interstate character of the service. The Federal Communications Commission has also recently recognized the interstate nature of interstate FX just as it did with regard to MTS-WATS: "Although MTS-WATS 'like' calls (such as FX) are interstate end-to-end, and should be treated as interstate in their use of the telephone companies' exchange facilities for purposes of jurisdictional separation of the telephone companies' cost and revenue division, this has not been the case. . . ." (Gabel Direct, p.6).

96. The Commission finds that interstate FX costs should not be bifurcated with part going to interstate and part to intrastate. Given the interstate nature of the service from end-to-end, the Commission finds that Gabel's

allocation of these costs out of the intrastate jurisdiction is warranted.

97. The Commission finds that Mountain Bell is entitled to \$6,514,000 of additional yearly gross operating revenue as follows:

Schedule 1
Mountain Bell
Results of Operations
Montana Intrastate - 1978
(000)

	Per Books (A)	Adjustments	Adjusted
1. Local Service Revenues	\$ 43,790	\$ 2,068	\$ 45,858
2. Toll Service Revenues	34,863	(115)	34,748
3. Miscellaneous Revenues	5,526	549	6,075
4. Less: Uncollectible	<u>(326)</u>	<u>(30)</u>	<u>(356)</u>
5. Total Operating Revenues	\$ 83,853		\$ 86,325
6. Wage Expense		2,320	2,320
7. Maintenance Expenses	\$ 14,421	652	15,073
8. Depreciation Expenses	10,944	522	11,466
9. Traffic Expenses	8,247	497	8,744
10. Commercial Expenses	10,118	296	10,414
11. Revenue Accounting Expenses	1,903	119	2,022
12. Other General Expenses	4,165	33	4,198
13. Operating Rents	840	-0-	840
14. Relief and Pensions	6,306	562	6,868
15. General Services and Licenses	<u>1,628</u>	<u>(950)</u>	<u>678</u>
16. Total Operating Expenses	\$ 58,572		\$ 62,623
17. Net Operating Revenues	\$ 25,281		\$ 23,702
18. Federal Income Taxes	3,570	(1,547)	2,023
19. State Income Taxes	1,092	(67)	1,025

20. Social Security Taxes	1,906	155	2,061
21. Other Taxes	<u>6,709</u>	14	<u>6,723</u>
22. Total Operating Taxes	\$ 13,277		\$ 11,832
23. Net Operating Income	12,004		11,870
24. Interest Charged Construction	525	(525)	-0-
25. Miscellaneous Deductions	<u>46</u>	(46)	-0-
26. Net Operating Earnings	\$ 12,483		11,870
27. Average Rate Base	183,892	(28,336)	155,556
28. Rate of Return	6.79%		7.63%

Schedule 2
Mountain Bell
Revenue Deficiency at Present Rates
Montana Intrastate
1978 Test Year
(000)

1. Rate Base	\$155,556	
2. Recommended Rate of Return	9.70%	
3. Recommended Return		\$15,089
4. Adjusted Net Operating Income		<u>11,870</u>
5. Income Deficiency		\$ 3,218
6. Revenue Deficiency		<u>\$ 6,514</u>

98. In its application the Company made provision for increased independent Company toll settlements. The Commission acknowledges that, because of rate increases granted by this order, Mountain Bell will incur additional expenses in its toll settlement procedures, with independent telephone companies. Also, no party to this proceeding objected to Mountain Bell's claimed level of expense. The Commission finds that the Company is entitled to revenues to offset toll settlements expenses. These revenues shall be recovered from local exchange service. It is anticipated that additional revenue shall be approximately \$788,000 annually. Thus, Mountain Bell's revenue deficiency plus toll settlements total \$7,302,000.

PART D

RATE STRUCTURE

99. The previous part of this order determined that Mountain Bell is subject to a test year annual revenue deficiency of \$7,302,000. On December 10, 1979, Order No. 4585 granted interim increases of \$3,204,000.

These uncontested increases, as provided in Schedule 3, are found acceptable to the Commission and will therefore remain at the levels authorized in the interim order.

Schedule 3 Interim Revenue Increase

Trim Line and Touch Tone	\$ 615,000
Intrastate Toll Service	1,415,000
Wide Area Telephone Service	78,000
Miscellaneous and Supplemental Equipment	570,000
Centrex (Non-Access)	296,000
Emergency Reporting Telephone Systems, Service Observing Equipment and	

Private Line Terminal and Channel Equipment	40,000
Semi-public PBX Measured Trunks	<u>192,000*</u>
TOTAL	\$3,204,000

- This amount represents a percentage (60%) of the individual business line (1FB) charge. Any charge in 1FB will also alter this amount.

100. The remaining revenue deficiency, \$4,098,000, must be arrived at by accepting some combination of proposed rate increases. The remaining proposals by Mountain Bell for rate increases, as provided in Schedule 4, are contested by intervenors and/or protestants.

Schedule 4
Remaining Mountain Bell
Proposed Revenue Increase

Directory Assistance	\$ 432,000
Local Coin Telephone	604,000
Centrex (access)	312,000
Secretarial Bureau	42,000
Dis-aggregation	(990,000)
Service Charges	1,089,000
Private Line	2,047,000
Local Exchange	7,880,000
TOTAL	\$11,416,000

Directory Assistance

101. In their permanent rate case application, Mountain Bell proposed a procedure for charging a 20¢ toll on the fourth and subsequent Directory Assistance (DA) call per month. Due to the difficulty of maintaining directories in coin booths, the proposal exempted DA calls originating from coin telephones from the charge.

102. The Consumer Counsel proposed, and Mountain Bell concurred, to a charge for the sixth and subsequent call. Both parties endorsed the general concept of a toll charge for excessive DA use. The Montana Association of the Blind protested the proposal as an inequitable burden to the handicapped.

103. The Commission is of the belief that the existing tariff with no charge for abuse of DA is inequitable. However, the Commission rejects the proposed DA charge because of lack of a workable, cost-effective procedure. The Commission finds unacceptable a charge to the handicapped for DA and inter-exchange DA usage. The cost and/or effectiveness of the proposal to supply directories upon request to inter-exchange callers and issue credit cards to the certified handicapped has not been established.

Local Coin Telephone Service

104. Mountain Bell's Mr. Heinze provided testimony proposing an increase in Local Coin Telephone rates from 10¢ to 20¢. This proposal would generate \$604,000 in additional test year revenues. In support of his proposal, Mr. Heinze provided the Commission with cost and revenue figures which suggest an average monthly deficiency of about ten dollars per coin telephone (\$32.17 in costs versus \$22.25 in revenue).

105. Consumer Counsel witness Mr. Gabel urged the Commission to reject the proposal as unnecessary.

106. The Commission rejects the proposed increase in Local Coin Telephone Service. The Commission finds difficulty in two aspects of the Applicant's proposal. Even after accepting a

moderate suppression of usage, a 100 percent increase is not justified in light of the purported 44 percent revenue deficiency. Secondly, and as a reason for not adopting a moderate increase, the Commission is of the belief that the existing problem of arriving at the correct charge for usage would be exasperated, especially in light of the lack of a provision for change from a quarter.

Centrex

107. Mountain Bell's Mr. Reinking provided testimony which proposed increases in both access and non-access Centrex rates. The proposed non-access revenue increase of \$294,510 was uncontested and granted interim approval in Order No. 4585. As with the other interim increases, the Commission accepts the non-access proposal.

108. Although an increase in access Centrex rates is uncontested, the magnitude of the Applicant's proposed increase is contested by the Consumer Counsel. Mr. Reinking proposed increases of 47.16 percent (the average trunk percentage increase proposed) and a 44.56 percent (the average 1FR percentage increase proposed) increase in student dorm access rate. These percentage increases, although equivalent to those proposed for basic exchange service, were rationalized in terms of a cost study revealing a subsidization of access Centrex. Mr. Reinking stated that the proposed rates would result in a 10 percent contribution over the estimated "avoidable costs" resulting from the cost study.

109. Mr. Gabel's testimony suggests that the Applicant's "avoidable cost" study is insufficient in its representation of fully distributed cost (FDC). Mr. Gabel utilized an FDC study which indicated monthly FDC costs associated with Centrex CU and C O f \$15 and \$18, respectively. Mr. Gabel urged the Commission to adopt these FDC costs as a basis for setting CU and C O rates of \$15.16 and \$18.00, respectively. This proposal would generate \$1,796,921 in additional test year revenues.

110. Although the Commission finds Mr. Gabel's testimony persuasive, it rejects his proposed access rates. Centrex, in its competitive setting, is a service approaching obsolete status. The Commission, although well aware of subsidization, is of the belief that the Consumer Counsel's proposal would result in a premature retirement of Centrex. The Commission finds an adequate moderation in Mountain Bell's proposal. Accepted is an increase in both Centrex C O and CU access equivalent to the average percentage increase in basic exchange service resulting from this Order. This will result in approximately \$106,000 in additional test year revenues.

Secretarial Bureau

111. Mountain Bell proposed an increase in Secretarial Bureau Services (telephone answering service switchboards) revenue of \$42,000. Witnesses for the Telephone Answering Services of the Mountain States contested the proposal .

112. The Commission chose not to address this proposal in this Docket. Rates for Secretarial Bureau Service will be addressed in Docket No. 6714 - - vertical services.

Dis-aggregation

113. Mountain Bell proposed a dis-aggregation package consisting of six elements. Five of these elements involved the extraction of the \$.70 per month standard telephone set charge from the line charges for extensions, premium sets, lines terminating in customer-provided equipment, Centrex and PBX's, and Touch - Tone sets. The remaining item is a proposal to eliminate the \$2.00 extension charge on obsolete (grandfathered) key systems.

114. Mr. Gabel proposed an "unbundling" of rates. His proposal entailed separating the flat exchange rate into an access charge and a charge for the premise wiring and telephone set. This pricing mechanism with the necessary provisions would allow for the proliferation of customer - owned premise wiring (COPW).

115. Two considerations underlie the Commission's rejection of Gabel's proposal: "unbundling" would allow those with customer-provided equipment the use of Mountain Bell wiring without charge and the proposal is premature absent regulations which govern the installation of COPW.

116. Separation of the set charge from the line charge as proposed by Applicant clarifies the billing format and insures that subscribers pay for a Mountain Bell set only when they use one. Further, dis-aggregation eliminates the current double-charging for extension sets on obsolete key systems. Accordingly, the Company's dis-aggregation proposal is accepted as a just and reasonable means of requiring the

cost-causer to bear the costs he causes and only those costs. Implementation of dis-aggregation will reduce test year revenues by \$988,000.

117. The Commission finds Mr. Gabel's "unbundling" proposal of merit. However, the resolution of numerous problems associated with the establishment of COPW provisions (e.g. lost revenue, prices, acquisition of existing installed wire, safety provisions, etc.) are not sufficiently addressed in the record .

Service Charges

118. This category of rate proposals includes service charges for residential and business exchange usage, charges for suspension and restoral of service, and the maintenance of service charge.

119. Testifying on behalf of Mountain Bell, Mr. Marquardt provided the Commission with a proposal for increasing service charges to generate \$1,053,000 in additional test year revenue. The proposal was based on two objectives: the identification of cost causative components and a resulting rate to generate sufficient revenue to cover the costs of providing the service.

120. Although Mr. Gabel generally concurred with Mountain Bell's objectives, he challenged three distinct cost elements. He proposed to extract the capitalized expense portion of the Company's estimated cost. He also proposed the extraction of the cost of promoting premium equipment and the Company's directory operations. The rationale for the latter

proposal is the sales revenue received from the directories, which generally offsets the expenses .

121. Mr. Gabel's remaining suggestion concerning the Applicant's proposed service charges was an end to the Company's procedure of subsidizing service ordering as a means of promoting sales of service. Mr. Gabel rationalizes his proposal in terms of telephone service saturation levels in Montana .

122. The Commission rejects the Company's proposed service charge schedule. In light of the fact that 96 percent of the residences in Montana have telephone service, a subsidy for service ordering with the objective of promoting sales of service appears unreasonable. Mr. Gabel's proposed extraction of capitalized expenditures, promotion expenditures, and directory costs is also accepted. The elimination of the capitalized expenditures from the service charges is consistent with Mountain Bell's proposal for pricing Private Line nonrecurring services.

123. Due to the dominance of capital expenses in initial charges, the accepted service charges will result in increased charges for main station moves and decreases in charges for initial main station installations.

124. Schedule 5 provides the service charge schedule proposed by Mr. Gabel and accepted by the Commission. These charges will result in an annual test year revenue decrease of about \$27,000.

Schedule 5
Approved Service Charges

	Residential	Business
Service Ordering Charge		
Order, New or Addtl. C.O. Line	\$11.50	\$20.60
Order, Other Moves or Changes	14.00	21.00
Order, Record Changes Only	6.85	9.90
Premises Visit Charge		
Connect, New	-0-	-0-
Move or Change Service	6.30	6.30
Central Office Line Charge		
Install or Connect, New	4.25	4.25
Move, Change or Rearrange	5.85	6.95
Inside Wiring		
Pre-Wiring	-0-	-0-
Post-Wiring		
Install, New	-0-	-0-
Move or Change	11.35	13.80
Jack Charge		
Connect	-0-	-0-
Move or Change	5.20	4.90
Station Handling		
Connect	-0-	-0-
Move or Change	2.60	2.65

125. Commensurate with his service charge proposal, Mr. Marquardt proposed increases in charges for restoral of suspended (either voluntary or for nonpayment) service.

126. Consistent with its rejection of the proposed service charges, the Commission does not accept the proposed increase in charges for restoral of suspended service. Those charges shall remain at their existing level.

127. The Commission also rejects the Company's proposed increase in the Maintenance of Service charge. Mountain Bell

has failed to adequately demonstrate the cost justification for its proposal.

Private Line

128. A substantive portion of Mountain Bell's rate increase application involved a major restructuring and re-pricing of Private Line services. Mountain Bell's Mr. Israelson provided testimony on seven Private Line cost studies. Mr. Ishoy's testimony utilized the cost studies to arrive at a proposed restructuring and re-pricing of Private Line.

129. Consumer Counsel witness Mr. Gabel and several witnesses representing Telephone Answering Services (TAS), provided testimony aimed at rebutting all three components of the proposal -- the cost studies, the restructuring and the re-pricing.

130. The main thrust of Mr. Israelson's cost studies was directed to identifying cost causative components of Private Line and assign each component a cost reflecting "current costs. " The cost studies considered both recurring and nonrecurring costs and resulted in both aggregation and disaggregation of various elements of Private Line services.

The cost studies performed by Mountain Bell confirm an uncontested severe under-pricing of Private Line services.

131. Mr. Gabel attacked the cost studies on several specific, as well as general, points. The specific points include underestimation of various cost components, including labor, loop, local channel and Service Area Function (SAF)

costs. Generally, Mr. Gabel's testimony addressed Mountain Bell's alleged faulty use of "forward looking incremental costs. " The correct approach, as purported by Mr. Gabel, is the use of "average fully embedded costs" as an indicator of costs. The embedded cost approach would utilize the investment data derived from the Division of Revenue analysis.

132. Mr. Gabel's testimony suggests an overall underestimation in Private Line costs as represented by Mr. Israelson's cost studies.

133. Testifying on behalf of the TAS were Ms. Corbett, Mr. Omundson, Ms. Berthelness, and Mr. Johnson. In regard to the cost studies, the TAS testimony addressed three distinct issues. The first premise provided by the TAS was that the Private Line cost studies are not applicable to them since they are connected to the Public Switched Network; i.e. they (TAS) are not Private Line subscribers. TAS testimony also questioned the concept of "current costs." It was argued that the system of equipment utilized by current TAS has already been paid for in recurring charges and that a more reasonable approach to pricing this system is "vintage pricing." Vintage pricing, rather than an estimation of current costs, would focus on the costs originally incurred. Ironically, the vintage pricing proposed by TAS is theoretically similar to Mr. Gabel's proposed embedded costs. Mr. Gabel's proposal, however, is in support of higher rates while the TAS are attempting to justify lower rates.

134. Pursuant to the cost studies was a Private Line restructuring proposal. The thrust of the proposal was the elimination of the mileage sensitive loop rates, in favor of the "loop-is-a-loop" average rates and delineation of the SAF

rate component. The remaining elements of the Applicant's restructuring proposal were directed toward identifying specific physical cost components.

135. The Applicant's proposed restructuring was rationalized as an aid to tariff administration on the part of the Company as well as the subscribers. The restructuring, as proposed, would facilitate the identification of costs associated with the proliferation of customer provided terminal equipment, achieve uniformity with the tariffs in other jurisdictions, and direct the burden of cost paying to the cost causer.

136. Mr. Gabel, in regard to the restructuring, testified on behalf of extending the "loop-is-a-loop" concept to inter-office trunks. His general recommendation to the Commission in regard to the actual restructuring was rejection. His rejection proposal was based on the loss of Division of Revenue cost accountability.

137. Mountain Bell, in its application, proposed re-pricing Private Line so that the costs incurred in providing the service are covered by revenue received and allowing for a slight contribution to the Company's overall overhead expense. This proposal entails a 102 percent increase in recurring rates and a 787 percent increase in nonrecurring rates, a total increase in test year revenues of \$2,047,200.

138. Mr. Gabel argued that the Applicant's proposed rate increase is "minimal" and would result in continued subsidization of Private Line subscribers by its monopoly operations.

139. The TAS testimony in regard to the re-pricing proposal was directed to expressing the possible impacts. Of primary concern was the nonrecurring secretarial service patron hookup charge. Existing tariffs price TAS subscriber hookup charge at \$19. The Applicant's proposal would increase the hookup charge to \$74. Due to the nature of the TAS business (a high turnover in subscribers), the TAS testimony focused on the possibility of the Applicant's proposed rates resulting in direct termination of their livelihood.

140. The Commission, in considering the testimony provided by Mr. Israelson and Mr. Ishoy, as well as Mr. Gabel's testimony, finds the proposal to restructure and reprice Private Line services persuasive. The Commission finds the Applicant's proposed restructuring an improvement to the alternative -- the existing structure. The trend toward cost causative pricing (charging the consumer for costs directly resulting from the consumer's behavior) is the correct approach to pricing Private Line. Although Mr. Gabel's criticism of the Applicant's restructuring proposal was directed, primarily, to its unaccountability, he fails to demonstrate that the alterations he proposes would result in increased accountability.

141. The TAS argument that their systems are not receiving Private Line services is rejected. Also rejected is the concept of vintage pricing. Although the uniformity and simplification of Private Line tariffs and the proposal to price them at a level that reflects the cost incurred in providing the service are accepted as valid, the fact that the TAS, as well as the other Private Line subscribers, have been historically receiving an improper price signal, and that the proposed rates present a radical change in that

price signal, warrants moderation in the rates proposed by the Company.

142. The Commission finds that an adequate and fair moderation towards full cost pricing of Private Line services can be arrived at by increasing the nonrecurring revenues by 100 percent, or 12.7 percent of the increase proposed by Mountain Bell. This increase will generate \$72,000 in additional test year revenues. The recurring revenues are to be increased by 75 percent, or 74 percent of the Applicant's proposed increase. This will generate an additional \$1,090,000 in revenue. As an additional mitigation procedure, and to prevent any windfall reduction in rates due to the overall mitigation and restructuring, the revenue increase accepted above will be partially arrived at by lowering no aggregate Private Line charge from the existing tariff levels.

143. The total additional test year revenues resulting from the accepted restructuring and re-pricing of Private Line services is \$1,162,000 -- roughly half of that proposed by the Applicant.

Local Exchange Service

144. This category of proposed rates includes basic exchange service and 11 various services associated with basic exchange. Proposed for these services were two elements: restructure and (or) re-price. Following is a discussion of each element, beginning with restructure.

145. Testifying for the Applicant was Mountain Bell employee Mr. Lou Marquardt. Mr. Marquardt proposed three changes in the basic exchange rate structure. He proposed to convert the basis of rate group designation from number of telephones to number of terminals. The reasoning for this proposal is the proliferation of customer owned telephones. Also proposed was the collapsing of the number of rate groups from nine to six. The reasoning behind this proposal was administrative ease, tariff simplification, and the fact that nine rate groups are unnecessary to maintain an "adequate cost differentiation." The third restructure component involved the relationship between multiparty rates and individual line rates for each rate group. Whereas the existing tariffs price multiparty service as a varying percent of individual line, dependent on the rate group, the proposed tariff utilizes a constant percent.

146. The Commission accepts the Applicant's proposal to base rate group classification on number of terminals. However, the proposal to collapse the number of rate groups from nine to six is rejected. Although the Commission considers the consolidation of rate groups to a level even less than six a meritorious proposal, it must be achieved, unlike the Applicant's proposal, in a method (such as a grandfather procedure) resulting in no discriminatory reclassification between the various communities.

147. The Commission finds the Applicant's proposal for uniformity in multiparty/individual line rate relationships acceptable. The actual percentages proposed are also accepted, with one exception. Eight-party rates are to be set

at some uniform percent of private line rates that maintains the current annual revenues generated from the current eight-party rates.

148. Also entered into the record was a proposal by Mountain Bell to restructure the Helena exchange. Included in the proposal was a delineation of two Suburban Rate Area (SRA1) zones in areas contiguous to the existing Helena and East Helena exchange boundaries. Also proposed were two small Base Rate additions to the Helena exchange and one larger addition to the East Helena exchange. The remaining component of the proposal involved the Leisure Village trailer court. Mountain Bell's density criteria suggest that Leisure Village warrants a Locality Rate Area #1 (LRA#1) designation.

149. This proposed restructuring of the Helena exchange would result in a \$36,000 reduction in annual test year revenues. The majority of that reduction (\$25,000) is a result of the proposal to create a rate point (LRA#1) in Leisure Village.

150. The Commission accepts the Applicant's proposed restructuring of the Helena exchange. The reduced revenue shall be offset by a commensurate increase in Local Exchange rates.

151. Proposed changes in rate structure of various associated local services include Measured Business Service, Joint User Service, Flat PBX Trunks, Semi-public Measured Trunks, Semi-public Coin Telephone, Specially Classified Service, Discounts and Concessions, and Call Waiting. With the exception of Call Waiting, these proposals would have the uncontested effect of increasing the rates for these

services. The rationale for the proposals was evidence of existing under-pricing and/or the motive for deterring usage.

152. Mountain Bell proposed to reduce the "free" message allowance for Measured Business Service from 100 to 60 and increase the charge from 6 to 7 cents per message for all messages over 100 per month. In effect`, this proposal increases the access charge from the residential level to the business level.

153. Proposed for Joint User service was an increase from \$6.00 for flat rate service and \$3.50 for measured service to 50 percent of the respective non-joint service (1FB and 1MB).

154. Whereas existing tariffs price Flat PBX Trunks at 150 percent of the businesses rate (1FB), the Applicant's proposal is a price equal to 160 percent of the business rate. In addition to the interim approval of restructuring Semi-public Measured Trunks (increasing the per trunk rate from 0 percent to 60 percent of the 1 FB rate), Mountain Bell sought to increase the per message toll from 6 cents to 7 cents.

155. In regard to Semi-public Coin Telephone service, Mountain Bell proposed a reduction in subscriber compensation from 15 percent to 10 percent. Also proposed was a uniform monthly rate equal to 65 percent of the 1FB rate. Existing tariffs price the service from 59.1 to 64.7 percent of 1FB depending on the rate group.

156. Two components of Specially Classified service, exclusive multi-line service and special concessions to

fraternal organizations and non-tuition and religious schools, were proposed to be eliminated. Under the Applicant's proposal, the exclusive multi-line service (presently only two subscribers) would be eliminated from the tariffs. The service would continue at the applicable multiparty rate. The special concessions entail pricing the first main station for the subscribers mentioned above at a residential rate rather than the otherwise applicable business rate.

157. Mountain Bell also proposed to eliminate Discounts and Concessions. This is a longstanding concession to clergymen and charitable organizations .

158. Currently, Call Waiting is offered only in Billings and Butte. The Billings rate is slightly higher. The Applicant is proposing, for advertising and administrative ease, to adopt a uniform state rate equal to the lower Butte rate. In rationalizing this proposal, Mr. Marquardt testified that the contribution received from Call Waiting at existing rates justifies the lower Butte rate. Consumer Counsel witness Mr. Gabel proposed the adoption of the higher Billings rate.

159. The Commission accepts the restructuring of these various local services as proposed by Mountain Bell with two exceptions. In regard to the elimination of the special concession to fraternal organizations and non-tuition and religious schools, the Commission finds the proposal to increase rates from residential to business excessive. As a moderation, the first main station rate will be increased to only the rate group 1, flat business rate, regardless of

community size. Secondly, the Commission does not choose to reduce subscriber compensation in Semi-Public Coin Telephone service. The Company's proposed reduction is not appropriate lacking an increase in pay phone rates which was earlier rejected by the Commission (Finding No. 106).

160. The remaining local services, Companion Line, Mobile Telephone service, and Service Station service, have no proposed restructure effect. However, these services, as well as those restructured are priced as a percent of the basic exchange rates and will therefore be re-priced via any change in basic exchange rates.

161. The re-pricing of Basic Exchange service and the associated services, as proposed by Mountain Bell, would generate an additional \$7,880,000 in annual revenues. This results from rate increases of between 30 and 70 percent, depending on rate group and line specification. Mr. Gabel testified that the rates could and should be lowered, depending on Commission action on other contested rate proposals.

162. Due to the complexity of precisely determining the annual revenue effect of specific changes in rate structure, Local Exchange service is necessarily priced residually. The Commission finds that the residual revenue requirement (the test year annual revenue requirement resulting from this order less revenue increases granted thus far in this order) shall be arrived at by increasing the restructured Local Exchange service rates. The increase shall be applied to all exchange classes except eight-party subscribers .

163. Schedule 6 provides a summary of the revenue increase resulting from this Order.

Schedule 6
Final Revenue Increase

Interim Order No. 4585	3,204,000
Centrex (access)	106,000*
Disaggregation	(988,000)
Service Charges	(27,000)
Private Line	1,162,000
Local Exchange	3,845,000*
 TOTAL	 7,302,000

* These amounts are approximations. Actual amounts depend on precise residual calculation with approved changes in rate structures.

PART E

Rural Telephone Service

164. Public hearings were held in Columbus, Billings, Forsyth, Miles City, Broadus, Missoula, Great Falls, Sidney, Choteau, Wolf Point and Lewistown to give ratepayers in those areas (primarily rural) a chance to testify on rates and charges proposed by Mountain Bell and quality of telephone service. The quality of telephone service appears to be of paramount interest to rural subscribers. The following are typical of statements received at the Choteau and Lewistown hearings:

All of the eight-party lines in our area are very old, and to my knowledge have had no improvements in them since their inception. It is my understanding that we are served by open wire lines which are on joint-use poles with Sun River Electric Cooperative. Power induction into the lines is a major source of noise, and we are constantly irritated with static and crackling,

making it impossible to converse, particularly long-distance.

* * *

Long-distance rates are costly, and our charges are expanded due to the ceaseless interruptions by low power, static and a capacity line. Our lines are out of service for days at a time, regardless of weather. And we always -- continually and constantly -- have loud background noise.

* * *

(as farmers) It is virtually impossible to make necessary calls when necessary, it is more impossible to expect any business to have patience to try for the long period of time essential to call back. Therefore, it is impairative (sic) that we travel to another phone. And here again, we are penalized by Mountain Bell because we cannot direct-dial and charge it to our phone, but we must go through the Operator which increases our cost, through no fault of ours.

* * *

We are surrounded by subscribers served by a Rural Telephone Co-op, which has given its phone users single-party service with buried lines at reasonable rates. (Norma Baker, Choteau, Montana - Choteau Hearing, Tr. pp. 12-14)

It cost me \$1,000 to get a phone for a mile. And two years ago, Mr. Tompkins came out and told us we would definitely have improved phone service. I drove to town five times this summer to call a repairman. He said call me any time, and we would fix it. You can call Mr. Tompkins (area serviceman) any time on a weekend but he isn't home. So, you get no service whatsoever. My wife and I run a modern ranch, our phone bill runs from \$150.00 to \$250.00. We are on a four party line and I want a private line but the rate is exorbitant on it.

* * *

I would definitely go with Mid Rivers.... I am fed up with being promised that they are going to do something and nothing happens.

* * *

And, on our four party line, every time the wind blows the phone doesn't work.... (Don Snider, Lewistown, Montana, Lewistown Hearing, Tr. pp. 41-43)
From time to time when the phone is out-- For instance, there was a telephone man from Great Falls who was working on this line out here one day, and I stopped and told him our phone was out. And he said "Well, you'll have to call Great Falls because we can't do anything about it. " Well, that's kind of an inconvenience for me to have to make an additional trip to come to town to tell them that the phone is out because you won't even get any service from your local phone people.

* * *

The differences in the services are so ridiculous
(between Mountain Bell and Three Rivers Cooperative) I
would be ashamed to even send out bills if I were you.
If I was running a business like you are running it, I
think I would have to hide my head all the time.
(Charles Crane, Choteau, Montana, Choteau Hearing, Tr.
pp. 19-20)

My husband is a veterinarian. We're on an eight-party
line. And we have had many complaints of people trying
to call through and can't get through.

* * *

As far as the business, we have had many many problems.
. . because we also have the same trouble with these
other people's phones; when they are out we cannot reach
them. They call from a neighbor's phone and say we need
a vet right now, and I have tried to reach them as to
when he can be there, and I cannot call them back to let
them know because their phone is out.

* * *

And they also told us we could have a private line if we
put it in ourselves; that Mountain Bell did not have the
money to maintain the line.

* * *

And also, Three Rivers can't have the area. If Mountain Bell can't afford to give service to this area, why can't Three Rivers have it?

* * *

The area we cover is large. And we'll have people call on our phone long-distance, and if it rings three times, all our neighbors are gotten up at 2:00 and 3:00 in the morning during calving season. Isn't there some way that they can't get our rings, we have eight parties? Not many people are going to be on it (at that time in the morning), so we are free to use it then, but why do the neighbors have to get this problem too. (Cheryl Nelson, Choteau, Montana, Choteau Hearing, Tr. 35-37)

I would just like to state my experience in the last two places I lived before I moved here and the telephone service I had prior to moving here. Number 1, I lived at Chinook under the Three Rivers Cooperative. I had excellent telephone service from the cooperative. And then, we also lived at Augusta under the Three Rivers Telephone Cooperative. And, when we moved here I couldn't believe when the telephone man came to install our telephone and told us we were on an eight party line when I had come off of a private line, an underground private line for \$12. 00 a month. And then to live here for a year and pay an increased rate for less service is something that to me is totally wrong in this day and age for telephone service. And, I feel that if we can't get the service in Lewistown from the private enterprise system, Mountain Bell, that we should seek elsewhere to find service, especially a cooperative type service.

(Gary Heilig, Lewistown, Montana, Lewistown Hearing, Tr. pp. 32-33)

...we have lived in this vicinity for fifteen years and we have always had an eight party line. And, I think it's time that we had better service. And, we have gone to the local phone company and talked to Mr. Tompkins about getting a private line and we have never been given any satisfaction on it.

* * *

CHAIRMAN BOLLINGER: You would like single line service?

THE WITNESS: We sure would and wouldn't mind paying for it. But, we really do need better service. (Core Lyn Lemmon, Lewistown, Montana, Lewistown Hearing, Tr. pp. 52-53)

My interest is to obtain a private phone. I don't like party lines. I have been on a party line most of my life. Each year I hate it more. One question I have for the Public Service Commission and Mountain Bell how are party line phones allowed to operate under the Privacy Act. I don't see how we can have privacy and yet have party lines. Maybe it falls under the right to know, the right to listen in on your neighbor's business. (John E. Lubinus, Lewistown, Montana, Lewistown Hearing, Tr. pp. 18-19)

Now, I think that Mountain Bell should have a -- well Mid Rivers has a limit, five or ten minutes, and then it automatically shuts that party off from talking. So,

then they would have to call back. It lets someone else get a chance for a few minutes. (Don A. Jarvis, Lewistown, Montana, Lewistown Hearing, Tr. D. 12)

165. At the Broadus hearing, Mrs. Georgia Damm, John Earley, Marlis Wolfgram, and Linda Dolan testified that adequate and reliable telephone service was vital to rural areas. Each recounted instances of peril which involved prairie fire, blizzards, and medical emergencies that were exacerbated by unreliable telephone service. Said testimony established that the rural eight-party lines were obsolete. The low hanging lines were a hazard to farm operations. The Broadus witnesses were emphatic that rates not be increased until after service is upgraded.

Mr. Earley and Mrs. Dolan indicated a desire to be released to Range Telephone Cooperative, whose service was characterized as good. Commissioner Schneider advised these customers that a petition for release could be submitted and that a response to said petition would be obtained from Mountain Bell. Mountain Bell subsequently contacted Range Telephone with an offer to release 32 area customers in return for \$59,601 which is based upon plant reproduction cost new adjusted for salvage and repairs.

166. Mrs. Ramon Nile and Mrs. Beverly Thompson generally represented a large body of customers in the Howard Valley west of Forsyth, Montana. They had circulated and submitted a comprehensive grievance petition with 69 signatures to the Commission on November 2, 1979. Said grievance petition was admitted into the record at the Forsyth hearing. The oral testimony of 15 public witnesses reinforced the serious

service and facility inadequacies established in the petition.

167. The public testimony in Miles City related in large part to the service problems in the rural Kinsey area. This testimony by 14 customers was similar in most respects to that in other rural areas discussed. The Commission notes that in several instances over the last five years petitions and letters from Kinsey area customers have sought service upgrades. The testimony of several customers lamented the single party buried service and reasonable rates afforded rural customers by the Range and Mid Rivers Cooperatives .

168. Based upon the record flowing from the satellite hearings, the Commission has no hesitation whatsoever in finding that eight-party rural service is clearly inadequate in most instances. The Commission finds this to be the case in spite of the fact that because of their physical isolation, rural customers have an even greater need for reliable service than other customers. The Commission finds that public safety is jeopardized by the existing inadequate service and facilities.

169. The Commission finds that deplorable conditions exist on several systems in rural areas. Existing rural lines are in most cases obsolete. Many rural areas continue to be served by farm lines that were originally installed by the customers themselves several decades ago and then later transferred to Mountain Bell for nominal consideration. Such systems have been the forgotten stepchild of the Mountain Bell system. There was very little evidence that the Company has made any substantive improvements on these systems since their installation. It is clear to the Commission that for

the past 20 to 30 years Mountain Bell has confined its investment primarily to the base rate and switching areas to the neglect of the less "lucrative" rural areas.

170. The Commission finds that service in rural areas has been allowed to deteriorate to such an extent that only a comprehensive rural improvement program will provide the reasonably adequate service and facilities required by law. As was pointed out by several public witnesses, repairs on a patch-work basis are not the answer.

171. Based upon evidence gathered in this docket, the Commission feels compelled by its public duty and its very conscience to require that Mountain Bell diligently formulate and exercise a comprehensive rural improvement program.

172. The Commission has detected a hesitation on the part of management of Mountain Bell to instigate such a program on their own. Commission questioning at the Helena hearing revealed that management of Mountain Bell realize that rural service is not adequate, but contend that earnings are not high enough to improve quality of service:

Q. Mr. Remington, do you consider, does Mountain Bell in Montana consider eight party service to be adequate today?

A. I believe, Mr. Schneider, that we have had a number of rural customers who have told us that they feel that eight party service is not adequate. And I believe that in our discussions that there are some who have told us that they feel that the eight party is adequate. So I would have to say eight party service is not adequate for everybody. I feel that it is probably not.

Q. What is the current status of what was formerly called the RIP Program or proposal for rural improvement?

A. At this point in time, as you know Mr. Schneider, we filed a RIP program earlier. And, then had, as I recall, one day of public hearing, and then ask that we temporarily put that off. And, the main reason at that point was because we had a fairly recent rate order which caused us to reassess that particular situation. The current status is that we would very much like to still be doing a RIP program, however, we do not feel that at the level of earnings that we had that we were able to afford to do that. (Commissioner Schneider's Cross-Examination of Mr. Remington, Tr. p. 53)

173. Point No. 16 of the Consolidated Motions Bifurcated Hearing, For Continuance Of Applicant's Presentation, And For Leave To File Amended Application And New And Supplemental Prefiled Testimony filed by attorneys for Mountain Bell in the currently pending rural improvement docket (No. 6570) stated:

Applicant further believes that the public interest will be best served if this Commission allows a recess in said matter after the submission of all public witnesses' testimony and exhibits including those of the Montana Consumer Counsel in order that this Commission, the Montana Consumer Counsel, the Applicant and all other parties interested be allowed to fully assess the public needs and desires with respect to rural service.

Point No. 17 goes on to state that once Mountain Bell had assessed the public needs and desires that it would "be prepared to better present its rural improvement program. " The motions were granted October 18, 1978.

174. Mr. Remington, in response to questioning by Chairman Bollinger, stated that the Rural Improvement program should be re-examined:

I am not sure I am making this perfectly clear, but my concern is then to continue with the R I P program as we looked at it, and I think it needs to be re-looked at, and this is one thing that I want to talk about. I think we got to get in and make updates of those studies because they are probably about two years old now... (Tr. p. 85)

175. The Commission finds no reason why Mountain Bell should not move to improve the quality of its rural service

at this time. Revenues have been provided in this order allowing Mountain Bell stockholders the opportunity to earn a fair and reasonable rate of return -- a return which compensates stockholders for any risk they may face in providing for the construction of public utility property which provides high quality telephone service.. It is also readily apparent from the testimony of telephone subscribers and management that the "public needs and desires" have been stated and dictate improved rural service.

176. The Commission therefore will require that Mountain Bell file as part of Docket No. 6570 or in the alternative as a new docket a new and comprehensive rural improvement program.

177. The Commission strongly feels that any future assertion by Mountain Bell, that it is constrained from making rural improvements due to an inadequate level of earnings or because certain project areas are cost prohibitive, should be accompanied by a sincere willingness to release the involved areas or to sell or trade them on reasonable terms.

178. In further recognition of the inadequacy of eight-party service, the Commission will not grant any of the requested increase in eight-party revenues. Such revenues will remain at their present level.

PART F

Noticed Amount of Request for Increased Rates

179. The Montana Consumer Counsel argued that this Commission is constrained from granting rate relief in excess of \$6.97 million. The argument centers upon those portions of the application and notice of hearing addressing Mountain Bell's intent to waive any increase in rates above those allowed by Federal Wage and Price Guidelines.

180. Federal Wage and Price Guidelines in effect at the time of Mountain Bell's application and distribution of the notice of hearing would have allowed for an increase in revenues of \$6.97 million. Guidelines in effect at the time of the hearing and service of this order would allow an increase in revenues of \$14.437 million .

181. Upon review of the application and notice of hearing, the Commission finds that it is evident to all that the Company was asking for increased revenues in the amount of \$16.58 million but limited to such Federal Wage and Price Guidelines as may be in effect at the time of the Commission's order. In particular, the notice of hearing stated:

The Company in its application, has requested a permanent increase in rates which will result in an increase in the Company's revenues in an amount consistent with such anti-inflation guidelines as may be in effect at the time of the Commission's final Order.
(emphasis added)

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182. The Commission finds that it is constrained only from granting revenues in excess of \$14.437 million.

CONCLUSIONS OF LAW

1. Applicant, Mountain States Telephone and Telegraph Company is a corporation providing telephone and other communication services within the state of Montana and as such is a "public utility" within the meaning of Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

3. The rate base adopted herein reflects original cost depreciated values and as such complies with the requirements of Section 69-3-109, MCA, that the value placed upon a utility's property for rate-making purposes ...may not exceed the original cost of the property."

4. The rate of return allowed through the recognition of "double leverage" meets the constitutional requirement that a public utility's return must be "commensurate with returns on investments in other enterprises having corresponding risks and sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. " Federal Power Commission v. Hope Natural Gas Company, 320 U . S . 591, 603 (1944) .

5. Pursuant to Section 69-3-201, MCA, every public utility is required to furnish reasonably adequate service and facilities. Based upon its Findings of Fact 164 through 167, the Commission concludes that Applicant is not providing

reasonably adequate service and facilities in many of those rural areas served by multiparty lines. It is a proper exercise of this Commission's delegated authority to order that a utility take such steps as the Commission feels are necessary to insure reasonably adequate service and facilities in the future.

6. The rate structure authorized by the Commission herein is just, reasonable and not unjustly discriminatory.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The Mountain States Telephone and Telegraph Company shall file rate schedules designed to produce a test year revenue increase of \$7,302,000 from its Montana subscribers. This increase is in lieu of rather than in addition to that granted on an interim basis in Order No. 4685.

2. The increased revenues authorized herein shall be distributed among tariffed services as described in the Findings of Fact of this Order.

3. The increased rates authorized herein shall be effective upon the filing and approval of revised tariffs consistent with this Order.

4. Mountain Bell is further ordered to file with the Commission, within 90 days of the service date of this Order, a comprehensive rural improvement program designed to bring about reasonably adequate service and facilities in all rural areas within a reasonable time frame. The Company is allowed

the option of filing such a plan as part of existing Docket No. 6570 or as part of a new docket with a proposal for disposition of Docket No. 6570.

5. All motions and objections not ruled upon at the hearing or earlier in this Order are denied.

Done and Dated this 14th day of July, 1980, by a vote of
5 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER,
Commissioner

JAMES R. SHEA, Commissioner

GEORGE TURMAN, Commissioner

ATTEST;

Madeline L. Cottrill
Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana

Administrative Procedure Act, esp. Sec. 2-4-702,
MCA; and Commission Rules of Practice and
Procedure, esp. 38-2.2(64)-P2750, ARM.